IN THE

United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

SPOKANE & EASTERN TRUST COMPANY, *Appellant,* vs. UNITED STATES STEEL PRODUCTS COMPANY, *Appellee.*	No. 3983

Appellant's Petition for Rehearing

F. H. GRAVES
W. G. GRAVES
B. H. KIZER,
Spokane, Washington
Solicitors for Petitioner.

EMPIRE-PACIFIC PRINTING CO., SPOKANE

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Petition for Rehearing and Grounds Therefor.

The Trust Company prays a rehearing upon a single point; one which was not passed on in the opinion handed down. The grounds for the petition are these:

The $48,000 remittance which was made up in large part of the proceeds of plaintiff's check, was received by the Trust Company on the 22nd. In accordance with custom and the terms of the remittance, the money was credited to the general account of the Central Bank, where it was subject to drafts drawn by the Bank. On the 25th the Trust Company received a letter from Buckholtz which told of the source of the remittance. In the interim, however, it had paid to third persons a considerable part of the money received by it; such payments being made on drafts drawn by the Central Bank in the regular course of business, and presented for payment to the Trust Company in like course. As an alternative point, one to be considered in the event that the principal points were ruled against it, the Trust Company insisted, both below and on appeal, that it was entitled to credit for the payments so made, and to a deduction of their amount from the judgment given against it. So far as the opinions handed down disclose, that point was not considered. The Trust Company prays a rehearing in order that it may be considered and passed on.

Argument in Support of Petition.

The judgment in plaintiff's favor proceeds on the theory that trust property belonging to it came into the hands of the Trust Company. It is unquestionable that a *cestui que trust* may follow trust property belonging to him into the hands of a volunteer or of a purchaser with notice. It is equally unquestionable that a purchaser for a valuable consideration without notice "is entitled to full protection." 2 Perry, Trusts (5th ed.), §828. A typical case illustrating the latter rule is *Holly v. Domestic etc. Soc.,* 92 Fed., 745 (aff'd 180 U. S. 284). There an attorney had been entrusted with money for the purchase of certain realty. Instead of making the purchase he deposited the money in his private account, then paid with it, by means of his private check, a legacy which was due from him as executor of an estate. It not appearing that there was sufficient to charge the legatee with notice that its legacy was paid with trust funds, it was held that the *cestui que trust* could not recover the money from the legatee, the Court saying:

> "Neither in equity nor at law in an action for money had and received can he whose trust moneys have been perverted prevail against the title of one who has acquired them bona fide and for value. He who receives money or acquires negotiable paper in payment of a debt is a holder for value, and if he receives the money innocently, or acquires the commercial paper before its maturity, and without notice of any infirmity, has a perfect title which can-

not be subordinated to the equities of any third person."

With respect to the drafts paid by the Trust Company, it is obvious that it is in the position of a purchaser for a valuable consideration. The $48,000 remittance was treated as money belonging to the Central Bank, and from it were paid orders (drafts) drawn thereon by the Bank. If plaintiff is permitted to retake the trust fund without reimbursing the Trust Company for the payments it had made therefrom, the latter must lose the amount of such payments. It follows that the only theory which will justify a refusal to permit the deduction of those payments from the recovery against the Trust Company, is that it had notice that the fund from which it made the payments was a trust fund which belonged to plaintiff, upon which the Central Bank had no authority to draw generally.

The record does not permit the adoption of that theory. It is not pretended that the Trust Company was or could have been advised in any other way of the source of the remittance than through Buckholtz, as no other officer or employe of the Central Bank communicated with the Trust Company during the latter half of January. Buckholtz testified that the only officers of the Trust Company with whom he communicated concering anything relating to the affairs of the Central Bank were Messrs. Rutter and Triplett (Trans., 128-129), and that the sole information he gave them concerning the $48,000 remittance or its source was by letter; that

he did not telephone concerning it (Trans., 131). Mr. Rutter and Mr. Triplett both testified that the first information they received concerning the remittance and its source was contained in Buckholtz's letters of the 23d-24th (Trans., 227-237), both of which reached them on the 25th (Trans., 122, 108-109). There is absolutely nothing to cast doubt upon this testimony. True, Miner, an officer of the Seattle National Bank, testified that he had a conversation with Buckholtz on the 27th, in the course of which the latter said that he had told the officers of the Trust Company about the remittance and draft by long distance telephone. The witness explicitly admitted, however, that nothing was said tending to show the character or extent of the information given, nor the date when it was imparted. To quote:

> "He didn't tell me that he immediately called up the Spokane & Eastern by long distance; he told me he called them up on the date the cash letter was there. He didn't tell me that on the same day that the cash letter was there he called up the Spokane & Eastern and told them about it. There was no specific telephone call mentioned when he made reference to this cash letter. He simply said they were informed by means of long distance telephone call about the draft, but the date wasn't specified. I inferred from the conversation that it was on the date the cash letter came over. As to the draft that was drawn against the Spokane & Eastern, I inferred that he called them up to tell them on the date the draft was issued, but I am not saying for a moment that he specifically admitted he called them up about the draft. I don't

think the point was definitely fixed that he called them on the same date the draft was issued. I never did find out when he called them up to tell them about the draft, only that he had informed them by long distance about it. We didn't discuss correspondence at all. I didn't ask him about letters, but I did ask him about long distance. I said he informed them about this transaction; they might have called him up. He said he talked with Mr. Triplett about this draft by long distance. I didn't ask him what Mr. Triplett said. I had no curiosity on the subject of what Mr. Triplett said or how he took it; I merely wanted to know whether he had informed them. The scope of my employment was to get the information I thought was of value and he never told me what they said." (Trans., 75-76.)

It is worthy of remark that Miner testified that Mr. Nossaman, a Seattle lawyer who accompanied him, overheard some of this alleged conversation (Trans., 76). Mr. Nossaman, being called as a witness, did not corroborate Miner's testimony in any particular. He testified to no more than that he said to Buckholtz on the 27th "that it seemed to him that the Spokane & Eastern would not have appropriated the money if it knew of the outstanding draft of $51,000, and Buckholtz said they did know of it; he didn't tell witness how they had the information." (Trans., 99).

These conversations occurred two days after the Trust Company had been informed by Buckholtz' letter of the source of the remittance and of the draft, and in the light of that information had decided to refuse and had refused to pay the $51,000

draft. Mr. Nossaman's testimony, of course, casts no doubt on the testimony of Messrs. Rutter, Triplett and Buckholtz. Miner's testimony conflicts with theirs only in that he says Buckholtz told him that he (Buckholtz) talked about the draft over the telephone. Buckholtz denies that he told Miner anything of the sort (Trans., 131), and Miner's companion, Nossaman, does not corroborate him. But give full credence to Miner, and his testimony amounts to no more than this: that Buckholtz, at some time not fixed, told some officer of the Trust Company over the telephone something, neither substance nor effect stated, about the remittance and draft. It is apparent, therefore, that when, in discussing another branch of the case, the Court said in the opinion handed down that there was "credible evidence that the vice-president of the Spokane bank knew on the 21st by a telephone message of the cash remittance letter," it misapprehended the record. Miner, the only witness whose testimony tends to show that there was a telephone message relating to the subject, expressly says that nothing was said which tended to show when the telephone message of which he spoke was sent, nor what its contents were.

Moreover, uncontroverted facts show that Buckholtz did not telephone concerning the draft; at least prior to the time of informing the Trust Company by letter. In his letter of the 23d to Mr. Rutter he said:

> "Yesterday we mailed a $51,000 draft on you to the Seattle National Bank covering a large letter of items on other local banks, the net of which has been remitted to you and no doubt we will have a few dollars there to meet it. The draft will likely reach you Tuesday or Wednesday and if you pay it the overdraft created will be the limit to date of credit advanced this institution. Have Mr. Triplett ascertain the amount of the overdraft created if this draft is paid. If you do not pay it we are gone." (Tr., 231).

It needs no remark that this language is utterly incompatible with the notion that he had theretofore discussed the subject of the remittance and the draft over the telephone with the officers of the Trust Company.

Again, no other reason can be suggested for the Trust Company's refusal to pay the $51,000 draft than its decision to extend no further credit to the Central Bank, and its desire to apply the Bank's balance upon its existing indebtedness. Now, if the Trust Company had been informed by telephone at any time prior to the 25th of the source of the remittance and the outstanding draft, it is patent that as soon as it received the information it would have made the decision which it undisputedly did make on the 25th, when Buckholtz's letter was received, *viz.,* not to extend the additional credit which would be necessary if the draft were paid, and to apply the Central Bank's balance on its existing indebtedness. It is even more evident that, the decision reached, it would have paid no more of the Central

Bank's drafts, but would have at once applied the balance of its account on its indebtedness.

To put it shortly: When Buckholtz's letter was received on the 25th, self interest caused the Trust Company to decide that it would not pay the $51,000 draft when it was presented, and to apply the then existing balance of the Central Bank on its indebtedness. Had the information contained in that letter, or anything tantamount thereto, been earlier communicated by telephone, the same self interest would have caused the same decision as soon as the telephone message was received. Indeed, if the information had been communicated on the 21st, or at any time before the 25th, self interest would have been even more insistent in its promptings, for the balance of the Central Bank which could be applied on its indebtedness would then have been larger. The fact that the Trust Company continued to pay from the $48,000 remittance all drafts drawn by the Trust Company until the 25th, proves beyond question that it was not until that date that it was informed of the source of the $48,000 remittance and of the $51,000 draft.

It is said in the opinion handed down that the insolvency of the Central Bank was known to the officers of the Trust Company, and from that it may be argued that the latter was charged with notice that any money transmitted to it by the Central Bank was or might be impressed with a trust, and required to inquire into its antecedents before paying it out.

That certainly is not the law. Looking backward, the Central Bank is seen to have been insolvent for months before it closed its doors. During that time it was transacting its business in the usual manner, and entering into the customary engagements which all going banks must enter into. It did so under the sanction of the state banking department, which alone had authority to say when its operations were unsafe and compel it to cease business. The $48,000 remittance was made by it in the usual course of business, and there was nothing about it to create suspicion or cause inquiry. For months the Central Bank had been remitting daily large sums in drafts, checks, and other cash items, to the Trust Company, and paying its foreign, *i. e.,* other than local, debts by drafts drawn upon its account. Plaintiff itself put in evidence a day-by-day list of cash letters sent by the Central Bank to the Trust Company for credit during the months of October, November and December, 1920, and January, 1921. In October those remittances ran from $6,000 to $34,000 daily; in November from $3,000 to $26,000; in December from $1,000 to $15,000; and in January from $700 to $48,000. The total for the four months was over $1,000,000. (Trans., 92-93). In January there were a large number of cash remittances running from $4,000 to $7,000; two between $16,000 and $18,000; and a number of smaller ones (Trans., 140). These remittances were for the creation of an account against which the Central Bank could draw in payment of its obligations. The Trust Company

was its "principal and drawing correspondent"; nearly all drafts issued by the Central Bank were drawn upon the Trust Company except "when the remittance was in the extreme east or in California" (Trans., 96). From the 14th to the 27th of January the Trust Company paid the Seattle National Bank (payee of the $51,000 draft) alone approximately $47,000 in drafts drawn by the Central Bank (Trans., 140-141). Now, conceding that the officers of the Trust Company did know that the Central Bank was insolvent, what did their duty require of them? Bear in mind that in the State of Washington there is no other power than the state banking department that can determine that a state bank is insolvent and compel it to discontinue business. The courts are stripped of jurisdiction to interfere. Remington's Comp. Statutes 1922, §§3266, 3276. As the banking department sanctioned the Central Bank's continuance of business, how could the Trust Company question its right to continue? And what was the Trust Company required to do if it could question that right? Should it have proceeded on the theory that because the Central Bank was insolvent it had nothing but trust funds, and required the tracing of every remittance sent it, and of every draft drawn upon it, to the end that each draft should be paid from the particular fund upon which it was drawn? Manifestly nothing of that kind was possible. So long as the state banking department permitted the Central Bank to continue business, so long as it was conducting an ordinary banking busi-

ness and entering into ordinary banking engagements under authority of law, the Trust Company was bound to assume—unless directly informed to the contrary—that the Bank's engagements were lawful and that the money remitted was its money, which it had the lawful right to use in payment of any of its lawful debts. The case does not differ essentially from *McDonald v. Chemical Nat. Bank*, 174 U. S., 610, where the question was whether cash remittances made by an insolvent bank to another bank in the regular course of business should be treated as preferences in contemplation of insolvency. It was there said (p. 618) that:

> "It is matter of common knowledge that banks and other corporations continue, in many instances, to do their regular and ordinary business for long periods, though in a condition of actual insolvency, as disclosed by subsequent events. It cannot surely be said that all payments made in due course of business in such cases are to be deemed to be made in contemplation of insolvency, or with a view to prefer one creditor to another. There is often the hope that, if only the credit of the bank can be kept up by continuing its ordinary business, and by avoiding any act of insolvency, affairs may take a favorable turn, and thus suspension of payments and of business be avoided."

Now it will not do to set the transaction here involved by itself, as though it were the sole transaction of that character between the two banks, or as though there were something unusual inherent in it. Day after day for months the Central Bank had been remitting large sums to the Trust Com-

pany in checks and drafts. The remittance involved was of the usual character, differing only in that it was somewhat larger than the general run. The purpose of those remittances was to provide a fund for the payment of drafts drawn by the Central Bank in favor of third persons, to meet the engagements which every bank must make in the transaction of its regular, daily business. Without such a fund to draw on the Central Bank would have been obliged to forthwith suspend business. The refusal of the drawee to pay a single draft would have meant such an impairment of credit as to force suspension. As the remittances to the fund were made daily, so were the drafts drawn upon it made daily. There was nothing to connect the drafts with the remittances; nothing to indicate that one draft should of right be paid from a particular remittance while another was not entitled to be so paid. Of necessity all the remittances went into one general hotchpotch, from which all the drafts were paid in the order of their presentation. That being so, why was the Trust Company not warranted in treating this remittance as it did all the other remittances which it received from the Central Bank? Let us not confuse its right to apply this remittance upon the debt of the Central Bank to it with its right to use the remittance in paying drafts drawn by the Central Bank. The daily cash remittances, it may be conceded, were not intended to be used in paying the debt of the Central Bank to the Trust Company. Technically, no doubt, the Trust Com-

pany had the right, in the absence of explicit instructions to the contrary, to so use them, but the fact remains that the Central Bank did not expect they would be so used, but would be devoted to the payment of drafts drawn by it. There is, manifestly, a marked distinction between the Trust Company's use of the remittance in the payment of drafts in the regular course of business, in the manner it was intended to be used and as all remittances were used, and its use for the payment of a debt owing to the Trust Company.

Summing up, the point we now press upon the Court is that the Trust Company was warranted in paying the Central Bank's drafts out of the $48,000 remittance as they were presented without inquiring concerning the source of the remittance. The remittance was transmitted for credit precisely as all other remittances were. There was nothing to differentiate it from them; nothing to induce the belief that it was intended or ought to be set aside for a particular purpose. If the drafts of the Central Bank were to be paid as they were presented they had to be paid from that remittance. In illustration, the account of the Central Bank was overdrawn some $10,000 or $12,000 when the remittance was received. What was there to warn the Trust Company that the remittance, though made for the purpose of paying the drafts, generally, of the Central Bank, could not be used for that purpose, and if those drafts were paid the Trust Company must pay them from its own funds? On the

24th the Trust Company paid out of the remittance a draft for $17,798.38 drawn in favor of the Seattle National Bank by the Central Bank. How was the Trust Company to know that that draft ought to have been dishonored, and the $48,000 preserved intact to apply upon a subsequent draft in favor of the Seattle National Bank that was then in process of transmission? And obviously the Trust Company could not continue to act as correspondent for the Central Bank if it proceeded on the theory that the latter had no title to the cash remittances it was making daily, and that it was necessary to allocate remittances and drafts, so that if a remittance represented the proceeds of a particular collection, none but the draft issued in payment of that collection should be paid from that remittance. Refusal to pay a draft, unqualifiedly or until its antecedents were traced so that it could be determined whether there was a remittance from which it might properly be paid, would impair the credit and cause the suspension of the Central Bank. If it were the law that when a bank became embarrassed, no correspondent could safely receive remittances from or pay drafts drawn by it unless each draft was traced to the proper remittance and shown to be properly payable therefrom, there is no bank that could survive the least temporary embarrassment. As soon as its embarrassment was known it would become a pariah, with which no other bank would deal.

With respect to the drafts paid by it, the Trust

Company is unquestionably in the position of a purchaser for value of trust property. If it must lose the money it paid out, notice that the $48,000 remittance did not belong to the Central Bank must be imputed to the Trust Company. We know, as a matter of fact, that it had no such notice. If it were a question of using the remittance to pay the debt of the Central Bank to the Trust Company, it might well be assumed that, though it had notice, the latter was willing to take the chance of making the payment stick, for if it did not it would be in no worse position. Instead it is a question of paying out money to third persons, a transaction by which it could not gain, and by which it must lose if the remittance did not belong to the Central Bank. Obviously it had no notice or it would not have taken the chance involved in paying the drafts. Notice of a trust to the prejudice of a purchaser for value can never be imputed on suspicion. On this subject Mr. Justice Wolverton said in *Raymond v. Flavel* (Ore.), 40 Pac., 158, 166:

> "A court of equity acts upon the conscience, and it is upon the grounds of mala fides that a purchaser for value is affected with notice of a prior claim. The notice must be more than would excite the suspicion of a cautious and wary person. It must be so clear and undoubted, with respect to the existence of a prior right, as to make it fraudulent in him afterwards to take and hold the property. *Hall v. Livingston,* 3 Del. Ch. 348."

Such seems to be the general rule.

"Whilst it is held that the fact of notice may

> be inferred from circumstances as well as proved by direct evidence, the proof must be such as to affect the conscience of the purchaser, and must be so strong and clear as to fix upon him the imputation of *mala fides.* 3 Gratt. 494, 545, *Munday v. Vawter et als.* 2 Gratt. 280, 313, *McClanachan et als. v. Stiter, Price & Co.,* and 2 Johns. C. R., *Day v. Dunham,* 182. Professor Minor, in his admirable work, says the effect of the notice, which will charge a subsequest purchaser for valuable consideration, and exclude him from the protection of the registry law, is to attach to the subsequent purchaser the guilt of fraud. It is therefore, *never to be presumed,* but *must be proved,* and proved *clearly.* A mere suspicion of notice, even though it be a strong suspicion, will not suffice. 2 Min. Inst. 887, 2 edi., and cases cited."
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> *Vest v. Michie,* 31 Gratt., 149.
>
> See also *Enes v. Pomeroy* (Ore.), 206 Pac., 860.

Where, may we ask, is there any ground for even suspecting *mala fides* on the part of the Trust Company in paying the drafts of the Central Bank? One does not enter into a fraudulent transaction, whereby one is exposed to a heavy loss, unless there is a prospect of such gain that one may afford to take the risk of loss. There was no possible gain for the Trust Company in paying the drafts. If it knew or even suspected that the remittance did not belong to the Central Bank, and could not be used in paying its drafts, it is self evident that no draft would have been paid therefrom.

It is quite true, as the court remarks, that a "serious injustice" resulted to the plaintiff from the transaction involved. But serious injustice must

result to every one who is dealing with an insolvent bank when it suspends payment. Either plaintiff or the Trust Company must lose the amount of the drafts that were paid to third persons from the $48,000 remittance. Upon which of them, in equity, should the loss fall? Let us balance their accounts and see.

The Trust Company acted in the utmost good faith in paying the drafts. It paid them in the regular course of business, in the same manner and from the same source that it had for months, perhaps years, been paying the drafts of the Central Bank. That it could not have suspected that it had no right to pay the drafts from the particular remittance is proven by the fact that it could not profit, and if its right to pay was in doubt could only lose, by making the payments. If the remittance was a trust fund, the trust upon which it was held was a secret one. And manifestly one will be protected who deals with trust property without notice of the secret trust by which it is affected.

Plaintiff entrusted the collection of its check unreservedly to its agent, the Seattle National Bank. It is, of course, chargeable with the result of its agent's acts. The Seattle National Bank might have directed that the proceeds of the collection be sent directly to it. Had that been done, no loss would have fallen upon any one. But the Central Bank was the regular correspondent and collecting agent at Yakima for the Seattle National Bank.

According to the regular course of dealing between the two, the Central Bank was authorized to mingle the proceeds of collections with its own funds, and settle therefor by a draft drawn upon its own funds in another bank—usually, if not always, the Trust Company. The regular course was pursued in the particular case, the Seattle National Bank having given no instructions to the contrary. The result was that there came into the hands of the Trust Company money which was *prima facie* the money of the Central Bank, which could properly be used as all money theretofore received from it had been: for the payment of any and all drafts drawn by it.

We submit that it was the act of plaintiff's agent in permitting the Central Bank to mingle the proceeds of the collection with its own funds, and settle therefor by a draft drawn upon its own funds which were deposited with the Trust Company, which rendered possible the loss that the Trust Company must sustain if the judgment of the District Court is affirmed, and it is not given credit for the drafts it paid before it was informed of the source of the $48,000 remittance. Plaintiff is responsible for the acts of its agent, for the Seattle National Bank was authorized to make the collection in any manner it saw fit. It is a "familiar principle 'that where one of two innocent persons must suffer by the acts of a third, he who has enabled such third persons to occasion the loss, must sustain it.' " *National Safe Deposit Co. v. Hibbs,* 229 U. S., 391, 394. Under that principle, as well as under the principle that

a purchaser for a valuable consideration is not affected by a secret trust of which he has no notice, the Trust Company ought to be given credit for the drafts it paid prior to the 25th.

Looking backward, from the viewpoint which this Court has taken of the law and facts involved in this case, the Trust Company is seen to have claimed more than its due when it insisted on its right to apply the balance remaining to the credit of the Central Bank on the 25th upon its debt to the Trust Company. That it did so may impeach the judgment of its counsel, but does not prove that its every action was inspired by bad faith. Because it claimed more than its due it cannot in justice be deprived of that which is its due. We therefore pray a rehearing, to the end that its right to a deduction of the drafts paid by it may be examined and, if equity so requires, the deduction be ordered made. Respectfully submitted,

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